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UNCLAS KINGSTON 001319

SIPDIS

STATE FOR WHA/CAR/ (WBENT), WHA/EPSC (JSLATTERY)

SANTO DOMINGO FOR FCS AND FAS

TREASURY FOR L LAMONICA

E.O. 12958: NA

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SUBJECT: PRICES REMAIN HIGH IN JAMAICA

1. Inflation, as measured by the consumer price index, rose by 13.2 percent for the Jamaican fiscal year 2004/05 (April - March). While this was below the 16.8 percent recorded for the comparative period, it outpaced the original target of nine percent. Inflationary impulses were fed by a prolonged drought and a devastating hurricane, which caused a 16.5 percent decline in agricultural production. The subsequent scarcity of domestic food supplies, in particular, caused a surge in prices. Inflation of 6.4 percent from September to December 2004 was largely the result of this hurricane.

2. Inflation moderated significantly during the first two months of 2005, but a 1.0 percent jump in March pushed prices for the quarter to 1.5 percent. The renewed impetus was driven by another bout of drought and the outbreak of several large bush fires in the breadbasket region of St. Elizabeth, which combined to stymie the recovery in agricultural production. The increase in prices has continued, with inflation for April reaching 1.9 percent, bringing inflation for January to April 2005 to 3.4 percent, 1.1 percentage points higher than the comparative period of 2004.

3. Inflation of eight percent has been programmed for the Jamaican 2005/06 fiscal year but the GOJ could be hard pressed to achieve this target, now that drought conditions have given way to flooding and landslides in agricultural areas. This will lead to further volatility in domestic food prices. Increased oil prices and the revised tax package implemented in April are also expected to fuel further inflation and inflationary expectations.

4. High inflation in Jamaica has traditionally been driven by monetary policy or core inflation and, in particular, increased money supply and instability in the foreign exchange market. However, recent inflationary impulses have been driven by cost-push factors and policy-induced shocks such as tax hikes. The reversal in this trend has been due to the Bank of Jamaica's commitment to manage base money, as well as to build up the stock of Net International Reserves (NIR) to bring order to the foreign exchange market. The stock of NIR now stands at USD 2 billion, the highest it has ever been in over a decade.

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